LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

301 State House
(317) 232-9855

FISCAL IMPACT STATEMENT

LS 7561
BILL NUMBER: HB 1716

NOTE PREPARED: Jan 31, 2003
BILL AMENDED:

SUBJECT: Enterprise Zones.

FIRST AUTHOR: Rep. Klinker
FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED:	**X**	**GENERAL**
	X	**DEDICATED**
		FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill has the following provisions:

A. It provides that the 30% valuation floor does not apply to the assessment of depreciable personal property located in an Enterprise Zone (EZ).
B. It provides retail merchants located in an EZ with an additional allowance equal to 1% of the retail merchant's Sales Tax liability.
C. It provides that the EZ Investment Cost Credit is assignable.
D. It allows the EZ Board to designate contiguous property in two municipalities as an EZ.
E. It establishes criteria for designation as a multijurisdictional EZ.
F. It provides that the number of EZs designated by the board may not exceed 29.
G. It provides a credit against state Sales and Use Tax liability for certain purchases made:
(1) by or on behalf of a taxpayer that owns real property in an EZ;
(2) from a person whose place of business is within an EZ or a city in which an EZ is located; and
(3) for the purpose of the redevelopment or rehabilitation of a business or residence in an EZ.
H. It extends the EZ Employee Wage Deduction to an employee employed by a pass-through entity.
I. It provides that an individual is entitled to an Adjusted Gross Income Tax Deduction equal to the amount of qualified increased EZ adjusted gross income received by the individual during the taxable year (including the individual's distributive share of a pass through entity's qualified increased EZ adjusted gross income).
J. It provides a credit against state tax liability for expenses incurred to train employees who reside in an EZ.
K. It provides a credit against state tax liability for jobs created at locations within an EZ.
L. It requires the State Human Resource Investment Council to include the president of the Association of Indiana Enterprise Zones or the president's designee.

Effective Date: January 1, 2002 (retroactive); July 1, 2003; January 1, 2004.

<u>Explanation of State Expenditures:</u> *Personal Property Assessments in EZs:* The state pays Property Tax Replacement Credits (PTRC) in the amount of 60% of school general fund levies attributable to all property and 20% of the portion of all operating levies (including the remaining 40% of the school GF levy) that are attributable to real property and non-business personal property. Homestead Credits are paid by the state in the amount of 20% of the net property tax due on owner-occupied residences.

The tax shifts from business personal property to other property in the bill would cause the state's expense for regular PTRC and Homestead Credits to increase. PTRC and Homestead Credits are paid from the Property Tax Replacement Fund, which is annually supplemented by the state General Fund. Therefore, any additional PTRC or Homestead Credit payments would ultimately come from the state General Fund. The additional state expense is indeterminable as personal property AV data are not available relating only to Enterprise Zone businesses.

<u>The fiscal impact of this provision will be updated as data are obtained relating to personal property assessed values in Enterprise Zones.</u>

Indiana Department of Commerce (IDOC) and Department of State Revenue (DOR): The IDOC would incur additional administrative expenses relating to the EZ boundary modifications. The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate tax deductions and credits established under the bill. These expenses presumably could be absorbed given each agency's existing budget and resources. The December 7, 2002, State Staffing Table indicated that there were 52 vacant full-time positions in IDOC, including regional office positions.

Enterprise Zone Board: The EZ Board receives an annual registration fee from each business that receives in excess of $1,000 in benefits from tax incentives provided through an EZ. The registration fee is equal to 1% of the benefits obtained exceeding $1,000. The multijurisdictional EZs and the expansion in EZ incentives provided for in the bill would increase registration fee revenue to the EZ Board. Potentially, this increase could be significant.

<u>Explanation of State Revenues:</u> *Multijurisdictional Enterprise Zones:* The bill allows the Enterprise Zone (EZ) Board to designate a new EZ or modify an existing EZ such that the EZ contains a contiguous area located in two municipalities. The bill also limits to 29 the total number of municipal EZs that the EZ Board may designate. There are currently 24 municipal EZs. Thus, the bill could potentially lead to the establishment of up to five new multijurisdictional EZs and the modification of existing single jurisdiction EZs into multijurisdictional EZs. This could potentially lead to new EZs in municipalities that individually are unable to meet the threshold criteria for an EZ. Also, this could potentially lead to an increase in the territory of existing EZs. Both of these outcomes could increase the total EZ incentives provided in the state. However, the fiscal impact of these potential changes is indeterminable.

Background - The bill requires that the executives of both municipalities must submit a joint application for designation or modification of an EZ as a multijurisdictional EZ. Under the bill, a multijurisdictional EZ generally must meet the same threshold criteria that a single jurisdiction EZ must meet. As with a single jurisdiction EZ, a multijurisdictional EZ must contain property that is suitable for development of a mix of commercial, industrial, and residential activities. However, for a multijurisdictional EZ, this property must be in both municipalities. In addition, two other threshold criteria are altered for purposes of a multijurisdictional EZ.

(1) A multijurisdictional EZ must have a population of more than 4,000 but less than 21,000 (current law requires a population of 2,000 to 10,500 for single jurisdiction EZs).

(2) A multijurisdictional EZ is limited in size to eight square miles (current law limits a single jurisdiction EZ to four square miles).

The Urban Enterprise Association (UEA) for a mulitijurisdictional EZ consists of 22 members instead of 12 members as required for a single jurisdiction EZ. Under current law, a UEA consists of two members appointed by the Governor and ten members appointed by the municipal executive. Under the bill, each municipal executive appoints ten members to the UEA. Current law does not provide for UEA members to be paid a salary per diem or reimbursed for incurred expenses. The incentives available in EZs are: (1) the employer income tax credit for wages paid to resident employees; (2) the employee income tax deduction for employees who live and work in the EZ; (3) the investment income tax credit for investors in start-up or expanding EZ businesses; and (4) the loan interest credit for interest earned by lenders on loans to EZ businesses or for real property improvements in the EZ. The personal property tax credit for inventory in an EZ will no longer be an incentive once the 100% inventory deduction under P.L. 192-2002ss takes effect with 2007 assessments. This could occur sooner if counties containing EZs opt to provide the inventory deduction beginning with 2003 assessments. In addition, the gross income tax exemption for EZ businesses has been eliminated due to the repeal of that tax under P.L 192-2002ss.

Personal Property Assessments: The state levies a tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds.

Sales Tax: The bill establishes a credit for Sales and Use Tax paid on purchases of building materials for Enterprise Zone (EZ) improvement projects, and provides an additional 1% collection allowance for retail merchants in EZs. As data is not available regarding EZ improvement projects, purchases of building materials by EZ businesses, or collections by EZ merchants, the impact of these two changes is indeterminable.

The bill establishes that a credit against a taxpayer's Sales and Use Tax liability is for the purchase of qualified building materials used to redevelop or rehabilitate a business or a residence in an EZ. The credit provided would be equal to 100% of the Sales and Use Tax paid on the purchase of the qualified building materials if the materials are purchased from a business located within an EZ. The credit is equal to 50% of the Sales and Use Tax paid if the materials are purchased for a retailer outside of the EZ, but within the city in which the EZ is located. For instance, if 40% of the cost of a $1,000,000 improvement project is attributable to building materials, then the credit could potentially range from $12,000 to $24,000. This assumes that building materials were purchased either from businesses in the same city but outside the EZ or from EZ businesses.

In addition, the bill provides for an additional 1% collection allowance to retail merchants located in EZs. This would increase the collection allowance for retail merchants located in EZs to 1.83% of the merchant's Sales and Use Tax liability. Under current law, retail merchants are entitled to a 0.83% collection allowance. The number of retail merchants operating in EZs and the total collection allowance paid to these merchants is unknown. Statewide, however, the average annual collection allowance is about $1,413 per retail merchant. Based on this average, the additional 1.00% collection allowance could potentially increase the collection allowance amount paid to <u>each</u> EZ merchant by an average of $1,702 annually.

Revenue from the state's 6% Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Loan Fund (0.033%).

<u>The fiscal impact of this provision will be updated as data are obtained relating to building materials purchases by EZ businesses and collection allowances of retail merchants operating in EZs.</u>

EZ Employee Wage Deduction: The bill expands eligibility for the EZ employee wage deduction to include EZ residents who are employees of pass through entities operating in an EZ ("S" corporations, partnerships, trusts, limited liability companies and partnerships). Under current law, EZ residents who are employees only of regular corporations and sole proprietorships are eligible for the deduction. The deduction is equal to the lesser of one-half of the individual's earnings or $7,500. As data are not available on potential EZ resident employees of pass through entities in EZs, the impact of this change is indeterminable.

For each eligible taxpayer who is able to deduct the maximum of $7,500, there would be a reduction of $255 in income tax liability. For each additional 1,000 employees who are eligible under this proposal, there would be a corresponding revenue loss of up to $255,000. Under current statute, 1,950 taxpayers deducted a total of about $12.1 M in ($6,184 on average) in income during 2000. This resulted in a tax liability reduction of about $410,000. In 1999, 1,386 taxpayers deducted approximately $8.9 M ($6,463 on average) in income for a reduction in revenue of about $305,000. Since this change is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

<u>The fiscal impact of this provision will be updated as data are obtained relating to pass through entities and employment by these entities in EZs.</u>

Deduction for Incremental Income Attributable to EZ Business Operations: Under the bill, each taxable year, an individual taxpayer would be entitled to an AGI Tax deduction generally equal to the difference between: (1) the adjusted gross income derived by the taxpayer from sources within the EZ during the taxable year; and (2) the adjusted gross income derived by the taxpayer from sources within the area comprising the EZ in the taxable year before the EZ was designated. (If the taxpayer derived no income from EZ sources in the year before the EZ was designated, this base year income is equal to zero.) The deduction would apply to individuals, sole proprietorship businesses, and income distributed to individuals from pass through entities ("S" corporations, partnerships, trusts, limited liability companies and partnerships). Thus, the bill would have the following two impacts on EZ businesses:

(1) An individual or business that <u>did</u> derive income from sources located in the area comprising the EZ prior to its designation would each year be entitled to deduct the increment of income attributable to its EZ sources in excess of this pre-EZ base year income amount.

(2) An individual or business that <u>did</u> <u>not</u> derive income from sources located in the area comprising the EZ prior to its designation would each year be entitled to deduct *all* of the income derived from sources in the EZ.

The deduction would apply to the following types of income derived from sources within the EZ: (1) income from real property and tangible personal property located in the EZ; (2) income from doing business in the EZ; (3) compensation for labor or services rendered within the EZ; and (4) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property having a situs in the EZ. The bill provides for a method of apportioning income to the EZ for individuals or businesses that can not separate income earned from operations inside and outside of the EZ. As data are unavailable on the earnings and sources of income of individuals and business entities with income producing operations in the EZs, the resultant revenue loss is indeterminable. However, the revenue loss could be ***substantial*** given that: (1) the deduction applies to any business (other than a regular "C" corporation) deriving income from sources in an EZ; (2) the deduction applies to individuals deriving income in EZs whether or not they reside in an EZ; (3) for some taxpayers, the deduction applies to a temporal difference in income that could straddle many years (depending upon EZ designation); and (3) for some taxpayers, the deduction would apply to all income derived from sources in an EZ.

Since this change is effective beginning in tax year 2004, the fiscal impact could potentially begin in FY 2004 (due to changes in quarterly tax estimates). Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

<u>The fiscal impact of this provision will be updated as data are obtained relating to sources of income and income levels of individuals and businesses operating in EZs.</u>

Assignment of EZ Investment Cost Credit: The bill allows a taxpayer receiving EZ investment cost credits to assign any portion of the credits to another taxpayer. Under current statute, a taxpayer is entitled to a tax credit of up to 30% of the cost of purchasing an ownership interest in an EZ business. The credit is nonrefundable. However, a taxpayer may carry over excess credits to subsequent taxable years. Assuming these credits would eventually be used by the taxpayer claiming them, the bill is likely to have no impact on tax revenue in the long run. Rather, the bill likely would provide for more timely use of investment cost credits obtained by taxpayers whose tax liabilities are not sufficient to exhaust the credits in one year.

<u>The fiscal impact of this provision will be updated as data are obtained relating to credit carry overs of taxpayers claiming the investment cost credit.</u>

Employment Training Credit and Job Creation Credit: The bill establishes two new EZ credits against the Adjusted Gross Income (AGI) Tax, the Insurance Premiums Tax, and the Financial Institutions Tax for employee training expenses and new employees. The EZ Employment Training Credit is a refundable tax credit for certain training expenses incurred by businesses located in a city that contains an EZ (regardless of whether the business operates in the EZ). The expenses must be incurred for training of employees of the business who are EZ residents. However, the bill does not limit the type or amount of training expenses that may be claimed for purposes of the credit. The revenue loss from this is indeterminable, but could potentially be significant given that it is not limited to EZ businesses nor to specific types or amounts of training expenses. The fiscal impact also would be contingent upon employer utilization and the EZ labor pool.

The EZ Job Creation Credit is a refundable tax credit equal to $1,500 for each new employee employed by the taxpayer at an EZ location during the taxable year. A new employee is an employee first employed by the taxpayer at the EZ location during the taxable year. It does not include an employee in a position previously held by another employee or an employee previously employed elsewhere in Indiana by another person or entity having a business relationship with the taxpayer. The amount of credits that could potentially be claimed by taxpayers is indeterminable. The net revenue impact depends on the extent that collections on compensation to new employees is less than or exceeds the amount of credits claimed by the business. However, if the employees would have been hired in the absence of the tax credit, the net impact would be the total credits claimed by the business.

Since the credits are effective beginning in tax year 2004, the fiscal impact could potentially begin in FY 2004 (due to changes in quarterly tax estimates). Revenue from the AGI Tax on corporations, the Insurance Premiums Tax, and the Financial Institutions Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund.

The fiscal impact of this provision will be updated as data are obtained relating to employment training and training expenses of EZ and other pertinent business entities; and employment and wage levels of EZ businesses.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Personal Property Assessments:* Under current regulations, the total value of a taxpayer's depreciable property located in the same tax taxing district must be at least 30% of the total cost of the property. This is known as the 30% valuation floor. This bill would remove the floor beginning with March 1, 2004, assessments for property taxes paid in CY 2005. The removal of the floor would reduce the assessed value of personal property which would shift part of the tax burden from personal property taxpayers to all property taxpayers. The extent of this impact, however, is indeterminable.

The fiscal impact of this provision will be updated as data are obtained relating to personal property assessed values in Enterprise Zones.

Local Option Income Taxes: The bill expands the EZ employee wage deduction and establishes a tax deduction for incremental business income earned in EZs. As a result, the bill would serve to decrease taxable income in counties containing EZs and imposing local option income taxes (CAGIT, COIT, and/or CEDIT). This would reduce revenue from these taxes. It is important to note, that the new tax deduction for incremental income earned in EZs could potentially have a significant impact on revenue from the local option income taxes.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue; Indiana Department of Commerce; Enterprise Zone Board.

Local Agencies Affected:

Information Sources: Indiana Department of Commerce; Local Government Database.

Fiscal Analyst: Jim Landers, 317-232-9869; John Parkey, 317-232-9854; Bob Sigalow, 317-232-9859.